

Message Text

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FM AMEMBASSY CAIRO

TO SECSTATE WASHDC PRIORITY 6179

INFO AMCONSUL ALEXANDRIA

C O N F I D E N T I A L SECTION 01 OF 05 CAIRO 06738

PASS TREASURY FOR BERGSTEN

E.O. 11652: GDS

TAGS: EFIN, IMF, EG

SUBJ: STATUS OF GOE/IMF NEGOTIATIONS; GOE REQUEST FOR

- USG SUPPORT

REF: CAIRO 5725

1. SUMMARY. GOE AND IMF NOW HAVE SUSPENDED NEGOTIATIONS ON EXTENDED CREDIT FACILITY SOUGHT BY EGYPTIAN ECONOMIC LEADERSHIP. SUBSTANTIAL AGREEMENT HAS BEEN REACHED ON BROAD RANGE OF REFORM QUESTIONS, INCLUDING DE FACTO DEVALUATION FOR MOST PURPOSES AND LIMITATION GOE SUBSIDY COSTS. THERE IS LACK OF AGREEMENT ON AMOUNT AND TIMING OF PUBLIC SECTOR PRICE INCREASES, HOWEVER, AND IMF TEAM HAS RETURNED TO WASHINGTON FOR FURTHER CONSULTATION ON THIS QUESTION. GOE HAS ASKED OUR SUPPORT THROUGH IMF IN FURTHERING THEIR DESIRE TO CONCLUDE AGREEMENT. DUE TO IMPORTANCE TO GOE OF MULTI-YEAR FACILITY IN ITS OWN REFORM PROGRAM AND NUMEROUS SIGNIFICANT POINTS ALREADY AGREED, EMBASSY RECOMMENDS USG RESPOND POSITIVELY TO THIS REQUEST. END SUMMARY

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2. MINECON EL SAYEH, AT CIP LOAN SIGNING FEBRUARY 27, APPROACHED AMBASSADOR WITH REQUEST FOR U. S. SUPPORT OF GOE EFFORTS TO CONCLUDE EXTENDED CREDIT FACILITY WITH IMF. MINECON REITERATED GOVERNMENT'S DESIRE TO OBTAIN THREE-YEAR FACILITY EXPRESSED EARLIER BY DEPPRIMIN KAISSOUNI (SEE REFTEL), CITING LONGER TERM IMPACT SUBJECT AGREEMENT WOULD HAVE IN COMPARISON WITH ONE-YEAR STANDBY AND FRAME-

WORK OF DISCIPLINE IT WOULD AFFORD IN GOE'S EFFORTS TO SET NEW COURSE FOR ECONOMY. EL SAYEH STRESSED THAT SUCCESSFUL NEGOTIATION OF A THREE-YEAR EXTENDED FACILITY WOULD FREE GOE TO FACE DISCIPLINE NEEDED THROUGHOUT THIS LONGER PERIOD, REGARDLESS OF WHAT MIGHT HAPPEN TO CURRENT TEAM OF ECONOMIC MINISTERS OVER THAT PERIOD. HE NOTED AGREEMENT HAS BEEN REACHED WITH IMF ON ALL POINTS WHICH COULD SUPPORT EXTENDED FACILITY EXCEPT TWO. THESE ARE MOVE TO UNITARY EXCHANGE RATE AND AMOUNT OF PUBLIC SECTOR COMPANY PRICE INCREASES TO BE AUTHORIZED. EL SAYEH IN EFFECT ASKED AMBASSADOR FOR USG ASSISTANCE IN CONVINCING IMF MANAGEMENT OF DESIRABILITY FROM GOE VIEWPOINT OF EXTENDED FACILITY AND, AT SAME TIME, INFEASIBILITY OF GOE AGREEMENT TO FULL EXTENT OF PRICE INCREASES REQUIRED BY IMF FOR CONCLUSION OF EXTENDED FACILITY AGREEMENT.

3. AMBASSADOR NOTED THAT FURTHER DETAILS

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PASS TREASURY FOR BERGSTEN

ON IMF DISCUSSION WOULD BE NECESSARY BEFORE EMBASSY COULD TAKE POSITION ON HOW TO PROCEED. MEETING IN THIS REGARD WAS ARRANGED FOR NEXT DAY BETWEEN DEPMIN HUSSEIN (PRINCIPLE ASSISTANT TO DEPPRIMIN KAISSOUNI) AND AID DIRECTOR, E/C COUNSELOR AND AID PROGRAM ECONOMIST. FOLLOWING IN SUMMARY IS INFORMATION DEVELOPED DURING LENGTHY CONVERSATION FEB 28 WITH HUSSEIN.

4. GOE AND IMF HAVE REACHED SUBSTANTIAL AGREEMENT ON

NUMBER OF ITEMS RELATING TO ACTIONS WHICH, IF UNDERTAKEN BY GOE, WOULD PERMIT CONCLUSION OF THREE-YEAR FACILITY (SEE BELOW). INCLUDED IS GOE COMMITMENT TO MOVE TO UNITARY EXCHANGE RATE, I.E., PARALLEL MARKET RATE, WITHIN ABOUT ONE YEAR FOR ALL TRANSACTIONS CONDUCTED WITH FUND MEMBERS. EXCLUDED FROM THIS FORMULATION OBVIOUSLY ARE TRADE AND DEBT CALCULATIONS WITH EASTERN BLOCK NON-IMF COUNTRIES, FOR WHICH PURPOSE GOE WISHES TO RETAIN THE CURRENT OFFICIAL RATE. HUSSEIN, UNLIKE EL SAYEH, DID NOT CHARACTERIZE THIS AS PROBLEM IN SEEKING AGREEMENT . WITH IMF FOR EXTENDED FACILITY.

5. MAIN PROBLEM AT THIS POINT IN CURRENTLY-SUSPENDED NEGOTIATIONS, ACCORDING HUSSEIN, HAS TO DO WITH PRICING .
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POLICY FOR PUBLIC SECTOR. HE NOTED THAT GOE HAS ALREADY TAKEN PRICING DECISIONS, MAINLY AFFECTING INDUSTRIAL GOODS, WHICH RESULTED IN LE 50 MILLION IMPACT ON ECONOMY IN 1977 AND LE 107 MILLION THUS FAR THIS YEAR. GOE FURTHER IS PREPARED TO INCREASE PRICE IN REMAINDER OF 1978 WHICH WILL RESULT IN ADDITIONAL LE 50 MILLION ECONOMIC EFFECT FOR A TOTAL OF APPROXIMATELY LE 150 MILLION IN PRICE IMPACT DECISIONS IN 1978. IMF, ON OTHER HAND, WISHES TO SEE PRICE POLICY TAKEN WHICH WOULD RESULT IN LE 250 MILLION IMPACT DURING 1978, WITH ADDITIONAL COMMITMENTS IN 1979, INCLUDING SPECIFICALLY A LE 50 MILLION OVERALL PRICE RISE DURING FIRST QUARTER OF THAT YEAR. IMF TEAM EVIDENTLY WAS ADAMANT ON THIS POINT AND

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C O N F I D E N T I A L SECTION 03 OF 05 CAIRO 06738

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HAS RETURNED TO WASHINGTON FOR FURTHER CONSULTATION WITH
FUND WITH RESPECT PRIMARILY TO DIFFERENCE BETWEEN IMF AND
GOE PUBLIC SECTOR PRICING.

6. AMONG ITEMS AGREED, "DEVALUATION" TO PARALLEL RATE
WOULD BE UNDERTAKEN EITHER AT FIRST OF 1979 OR ONE
YEAR AFTER SIGNING OF AGREEMENT. AS NOTED ABOVE,
"SYMBOLIC" OFFICIAL RATE WOULD BE RETAINED ONLY FOR NON-
FUND MEMBER TRANSACTIONS. GOE AGREED IN ADDITION TO SHIFT
FURTHER TRANSACTIONS TO PARALLEL RATE, ON EVIDENTLY
SUBSTANTIAL SCALE, IN INTERIM PERIOD PRIOR TO FORMAL
CHANGEOVER.

7. HUSSEIN PROVIDED CONSIDERABLE INFORMATION ON STATUS OF
REFORM MEASURES WHICH HE TERMED "AGREED UPON," ALTHOUGH
MINOR NEGOTIATING POINTS APPARENTLY REMAIN WITH RESPECT
TO SOME. (HE DID NOT, HOWEVER, CLAIM TO HAVE ALL RELEVANT
DETAILS AT HAND.) ON BUDGET DEFICIT, GOE AGREED TO HOLD
THIS TO LE 500 MILLION NEXT YEAR, INCLUDING PORTION OF
DEVELOPMENT BONDS ISSUED. SENSITIVE SUBSIDIES ISSUE,
ACCORDING HUSSEIN, WAS DEALT WITH IN GINGERLY FASHION BY
IMF, BUT GOE NONETHELESS UNDERTOOK TO HOLD TOTAL NEXT
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YEAR TO NO LARGER SUM THAN BUDGETED 1978, DESPITE EFFECT
MOVE TO PARALLEL RATE FOR BASIC COMMODITY IMPORTS WOULD
HAVE ON THEIR COST; HE SAID IN THIS CONNECTION IT WAS
OBVIOUS THAT GOVERNMENT WILL HAVE TO REDUCE CONSIDERABLY
INDIRECT SUBSIDIES ON OTHER THAN BASIC GOODS IN ORDER TO
MEET THIS COMMITMENT.

8. GOE ALSO HAS AGREED DURING THESE RECENT NEGOTIATIONS
TO SUCH MEASURES AS RISE IN BANK INTEREST RATES (ONE
PERCENT INCREASE BY APRIL 1978 AND ADDITIONAL ONE PERCENT
POSSIBLE DURING FIRST YEAR OF AGREEMENT); LIBERALIZATION
OF TRADE BY BROADENING OPEN LICENSING ARRANGEMENT AND
TERMINATING BILATERAL TRADE AGREEMENTS WITH IMF MEMBERS;
ADOPTING WAGE POLICY WHICH WILL PERMIT MODERATE AND
GRADUAL SALARY RISE DESIGNED TO AVOID OFFSETTING PUBLIC
SECTOR PRICE INCREASES; DECENTRALIZING PRICING AND
MANAGEMENT FUNCTIONS OF PUBLIC SECTOR (NOT TO INCLUDE
AUTHORITY TO FIRE WORKERS, HOWEVER), WITH MONITORING
OVERVIEW BY MINPLANNING; AND IMPROVEMENT OF BUDGETARY
FUNCTION ON BOTH COLLECTION AND DISBURSING SIDES, AS WELL
AS MORE SYSTEMATIC PREPARATION AND PRESENTATION OF ANNUAL

BUDGET EXERCISE. HUSSEIN ALSO NOTED THAT IMF HAD REQUESTED A SPECIFIC CEILING ON ALL FOREIGN BORROWINGS

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WITH REPAYMENT TERMS OF 15 YEARS OR LESS (AMOUNT OF CEILING UNSPECIFIED BY HUSSEIN), BUT THAT AGREEMENT HAD BEEN REACHED THAT CEILING WOULD APPLY ONLY TO BORROWING ON REPAYMENT TERMS OF SIX YEARS OR LESS.

9. HUSSEIN CONCLUDED PRESENTATION BY EMPHASIZING NEED IN GOE VIEW FOR EXTENDED CREDIT FACILITY. HE NOTED THAT IT WOULD HAVE BEEN EASIER FOR GOVERNMENT TO NEGOTIATE ANOTHER ONE-YEAR STANDBY; AGREEMENT FOR DEFINITE, TIMED MOVE TO UNITARY EXCHANGE RATE, FOR EXAMPLE, WOULD NOT HAVE BEEN NECESSARY IN THOSE CIRCUMSTANCES. GOE ECONOMIC LEADERSHIP, SUPPORTED BY PRIME MINISTER AND PRESIDENT, REALIZE FULLY UTILITY OF LONGER-TERM REFORM EFFORT UNDERPINNED BY FORMAL COMMITMENT TO IMF, HOWEVER. HUSSEIN COMMENTED THAT IMF TENDS TO VIEW ECONOMIC QUESTIONS IN TERMS OF FISCAL AND MONETARY POLICY, TO EXCLUSION, AT LEAST TO SOME EXTENT, OF POLITICAL AND SOCIAL CONSIDERATIONS. HE STRESSED THAT THESE LATTER FACTORS ARE IMPORTANT IN EGYPT, HOWEVER, AND GOE BELIEVES CURRENT PACKAGE OF REFORM MEASURES AGREED UPON OR PROPOSED BY GOE IS AS FAR AS IT CAN GO AT THIS TIME. USUAL PRACTICE IN CONTEXT OF IMF AGREEMENT IN ANY EVENT, HE NOTED, IS TO MAKE FIRM COMMITMENTS DURING FIRST YEAR OF PROGRAM AND TO LEAVE AGREEMENT UPON DETAILED UNDERTAKINGS IN SUBSEQUENT PERIODS
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OF MULTI-YEAR AGREEMENT TO LATER CONSULTATION. HUSSEIN SAID HE EXPECTED FURTHER PRICE INCREASES WOULD IN FACT BE UNDERTAKEN IN 1979 BUT GOE DOES NOT WISH TO SETTLE ON PRECISE AMOUNTS NOW UNTIL THEY SEE IMPACT OF ACTIONS PLANNED IN FIRST YEAR. HUSSEIN THEN ASKED FOR USG SUPPORT AT IMF STAFF AND BOARD LEVEL FOR GOE'S EFFORT TO CONCLUDE EXTENDED FACILITY AGREEMENT, ESPECIALLY WITH REGARD TO QUESTION OF EXTENT TO WHICH PUBLIC SECTOR PRICE RISES MUST BE IMPLEMENTED THIS YEAR. HE COMMENTED - ON WHAT APPEARS TO BE ARBITRARY LEVELS OF PRICE INCREASES S. REQUIRED BY IMF FOR SUCCESSFUL CONCLUSION OF NEGOTIATIONS. HUSSEIN INDICATED HE WOULD PROVIDE AT LATER DATE, IN SUPPORT OF GOE POSITION, FURTHER DETAILS ON COMMODITIES COVERED BY PRICE INCREASE DECISIONS. EMBOFFS TOLD HUSSEIN THAT WE WOULD MEANWHILE TRANSMIT GOE VIEWS AND REQUEST TO CONCERNED USG AUTHORITIES. HUSSEIN STATED GOE HAS ALREADY CABLED ITS EXECUTIVE DIRECTOR TO INTERCEDE WITH IMF MANAGEMENT ON THOSE MATTERS.

10. COMMENT: HUSSEIN'S PRESENTATION IN OUR OPINION REFLECTS FORTHCOMING, BROAD RANGE OF MEASURES TO BE

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UNDERTAKEN BY GOE. PROGRAM ENCOMMASSES LARGER NUMBER OF EXPLICIT REFORM ACTIONS THAN WE WOULD HAVE EXPECTED COULD BE AGREED TO IN SHORT NEGOTIATING PERIOD, NOW SUSPENDED. GOE HAS GONE FAR TOWARD ACCEPTED RATIONALIZATION OF EXCHANGE SYSTEM, FOR EXAMPLE, AND HAS SET DIFFICULT GOAL FOR ITSELF ON RELATED PROBLEM OF SUBSIDIES. DIFFERENCE

IN IMF AND GOE PRICE POLICY POSITIONS, AMOUNTING TO LESS THAN LE 100 MILLION IN IMPACT THIS YEAR, STRIKES US AS MOTELIKE IN OVERALL PICTURE. CERTAINLY GOE POSITION SHOULD BE SUBJECT TO FURTHER CONSIDERATION BY IMF MANAGEMENT WITH VIEW TOWARD CONCEDING POINT ON PRECISE TIMING AND AMOUNT OF PLANNED PRICE INCREASES. IMPORTANCE TO ECONOMY OF HAVING GOE COMMIT ITSELF TO A LONGER TERM, COMPREHENSIVE REFORM EFFORT OUTWEIGHS BY FAR, IN OUR VIEW, THIS DIFFERENCE OVER LE 100 MILLION PRICE IMPACT.

11. RECOMMENDATION: IN LIGHT OF GOE'S PERCEPTION OF IMPORTANCE OF EXTENDED FACILITY FOR ITS OWN ECONOMIC RATIONALIZATION EFFORTS AND RANGE OF SIGNIFICANT REFORMS ALREADY AGREED UPON, EMBASSY RECOMMENDS THAT USG ACTIVELY SUPPORT THROUGH U.S. EXECUTIVE DIRECTOR OF IMF EGYPTIAN REQUEST FOR EXTENDED CREDIT FACILITY, TERMS OF WHICH EVIDENTLY HAVE BEEN LARGELY HAMMERED OUT IN RECENT NEGOTIATIONS EXCEPT ON PRICE POLICY. WE WOULD URGE THAT

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PRICING QUESTION BE RESOLVED SUBSTANTIALLY ALONG LINES DESIRED BY GOE. EILTS

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